79-142

Supreme Court, U. S.
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In the Supreme Court of the United States

No. .....

SUSAN GARFINKLE, et vir.,

Respondents,

vs.

SUPERIOR COURT OF CONTRA COSTA COUNTY
(WELLS FARGO BANK, ET AL.,
Real Parties in Interest),

Petitioners.

Petition for Writ of Certiorari to the Supreme Court of the State of California

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In the Supreme Court of the United States

No. .....

SUSAN GARFINKLE, et vir.,

Respondents,

vs.

SUPERIOR COURT OF CONTRA COSTA COUNTY
(WELLS FARGO BANK, ET AL.,
Real Parties in Interest),

Petitioners.

Petition for Writ of Certiorari to the Supreme Court of the State of California

Petitioner prays that a Writ of Certiorari issue to review the order of the California Court of Appeal in the case of Susan Garfinkle and Gary Garfinkle, Petitioners, vs. Superior Court, Contra Costa County, Respondent, Wells Fargo Bank, et al., Real Parties in Interest; Number 1 Civil 45643 in that Court.

OPINIONS BELOW

The decision of the California Court of Appeal on Petition for Extraordinary Relief in the Nature of Mandamus directing the Superior Court to vacate its summary judgment and to enjoin assertion of due-on-sale rights, is attached as Appendix A.

JURISDICTION

The decision of an intermediate State Appellate Court is the decision of the highest Court of the State in which a decision

could be had, where the State's Highest Court has refused to review the decision. *Sullivan v. Texas,* 207 U.S. 416 (1908); *Hammerstein v. Superior Court,* 341 U.S. 491, 492 (1951); *Michigan-Wisconsin Pipe Line Co. v. Calvert,* 347 U.S. 157, 160 (1954); *Interstate Circuit, Inc. v. Dallas,* 390 U.S. 676, 678, n.1. (1968).

The decision of the California Court of Appeal is "law of the case"; *Tally v. Ganahl,* 151 Cal. 418 (1907); *Pigeon Point Ranch v. Perot,* 59 Cal.2d 227, 232 (1963); *People v. Shuey,* 13 Cal.3d 835 (1975); *Cooper v. County of Los Angeles,* 69 Cal.App.3d 529 (1977); and it is "final", for the mandate concludes this case on the federal question presented. *Pope v. Atlantic Coast Line R. Co.,* 345 U.S. 379, 382 (1953); *North Dakota Pharmacy Board v. Snyder's Stores,* 414 U.S. 156, 159-164 (1973); *Cox Broadcasting Corp. v. Cohn,* 420 U.S. 469, 479-485 (1975).

A copy of the order of the California Supreme Court dated May 3, 1979, denying timely Petition for hearing is attached as Appendix B. This Court has jurisdiction under 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

A decision of the California Supreme Court which changed the substantive law of contracts and property has been applied to contracts which were valid under the law of contracts and property in effect when the contracts were made.

The questions presented are:

(1) Whether impairment of contract rights by State legislative action prohibited by Article I, Section 10 is also prohibited by the Fourteenth Amendment guarantee of substantive due process.

(2) If so, whether the Fourteenth Amendment permits the State courts to impair contracts in a way which the State legislature could not constitutionally do.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Title 28 U.S.C. § 1257:

> "Final judgments . . . by the highest court of a State in which a decision could be had, may be reviewed . . . as follows: . . . (3) By writ of certiorari . . . where any right . . . is . . . claimed under the Constitution . . . of . . . the United States."

United States Constitution, Article I, Section 10:

> "No state shall . . . pass any . . . law impairing the obligation of contracts."

United States Constitution, Fourteenth Amendment:

> ". . . nor shall any state deprive any person of . . . property, without due process of law . . ."

California Civil Code Section 711:

> § 711. *Conditions restraining alienation void.* Conditions restraining alienation, when repugnant to the interest created, are void."

STATEMENT OF THE CASE

Petitioner's contract right to accelerate a note has been taken away by action of the State of California, acting through its courts.

In 1967 Petitioner loaned money on a note and Trust Deed, each of which included a due-on-sale clause providing that Petitioner could accelerate the maturity of the note if the borrower sold the house covered by the Trust Deed.

In 1967 it was settled law in California that due-on-sale clauses were valid and were not unreasonable restraints on alienation.

The California Supreme Court had held in 1964:

> "In the present case it was not unreasonable for plaintiff to condition its continued extension of credit to the Enrights on their retaining their interest in the property that stood as security for the debt. Accordingly, plaintiff validly provided that it might accelerate the due date if the Enrights encumbered or transferred the property." *Coast Bank v. Minderhout,* 61 Cal.2d 311, 317 (1964)

This decision was followed in *Jones v. Sacramento Sav. & Loan Assn.*, 248 Cal.App.2d 522 (1967); *Hellbaum v. Lytton Sav. & Loan Assn.*, 274 Cal.App.2d 456 (1969), and *Cherry v. Home Sav. & Loan Assn.*, 276 Cal.App.2d 574 (1969), Hearing Denied (1969).

In 1970 Mr. Garfinkle, a lawyer, and his wife, bought the property covered by Petitioner's Deed of Trust.

They bought knowing that the property was subject to a Trust Deed which contained a due-on-sale clause and that petitioners might refuse to permit assumption of the loan by them, if they would not agree to pay interest at the currently prevailing rate, which they could afford, but were not willing to do.

They contracted to assume, and if they could not assume, to pay off the loan.

As they foresaw, petitioner, because they would not agree to the currently prevailing interest rate, refused to agree to assumption, and in 1970 accelerated the Note and commenced proceedings to foreclose by exercise of power of sale.

Litigation commenced,[1] and Petitioner forbore pending disposition of the litigation from completing the foreclosure proceedings which it had commenced.

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1. The early history of the litigation comprised a series of unproductive legal actions. The Garfinkles first sued for injunctive and declaratory relief in the United States District Court for the Northern District of California. On appeal from a judgment of dismissal for lack of jurisdiction, the Ninth Circuit reversed, finding a substantial federal question, and directed the District Court to abstain and the Garfinkles to file a state action to resolve the issues. *Garfinkle v. Wells Fargo Bank,* 483 F.2d 1074 (9th Cir. 1973). The Garfinkles then filed a petition for original writ of mandate in the California Court of Appeal, which was denied for lack of reason to circumvent the Trial Court. The California Supreme Court denied a hearing. The Garfinkles, in 1977, commenced the present action in the California Superior Court, as could have been done in 1970. In 1978, the Garfinkles' petition for original writ of mandate on the issue of the constitutionality under the 14th Amendment of Power of Sale foreclosure was filed, resulting in decisions upholding such foreclosure. *Garfinkle v. Superior Court,* 21 Cal.3d 268 (1978); Appeal dismissed for want of a substantial federal question, ... U.S. ....., 99 S.Ct. 343 (1978). Petitioner took no action believing that the law of 1967 applied to its contract.

In April 1977 Petitioner moved for summary judgment on the due-on-sale issue.

In May 1978 the Trial Court stayed further proceedings awaiting final decisions in pending cases on the status of due-on-sale clauses, which had become unsettled by decisions of the California Supreme Court.

After *Coast Bank, Jones, Cherry and Hellbaum, supra,* a series of California cases involving due-on-sale clause were decided.

In 1971, the California Supreme Court in *La Sala v. American Savings & Loan Assn.*, 5 Cal.3d 864, 879, 883 (1971), said:

> "Following *Coast Bank,* three published Court of Appeal decisions have held that due-on-sale clauses in trust deeds do not constitute unlawful restraints on alienation . . .
> Thus, although California cases have clearly held a due-on-sale clause valid, the language in such cases respecting due-on-encumbrance provisions is . . . entirely dictim.

The Court thus affirmed the validity of acceleration on sale and held that a due-on-encumbrance clause was an unreasonable restraint on alienation, saying:

> ". . . We have concluded that the lender may insist upon the automatic performance of the due-on-sale clause *because such a provision is necessary to the lender's security.*" (emphasis added)

It had not previously been hinted that a need to protect the lender's security was a condition precedent to "automatic" enforcement of a due-on-sale clause. The need as a condition precedent was expressly rejected in *Cherry v. Home Sav. & Loan Assn., supra.*

In 1974, the California Supreme Court in *Tucker v. Lassen Savings & Loan Assn.*, 12 Cal.3d 629 (1974) considered a due-on-sale clause in an installment land sale contract in which there was a small down payment and very little equity in the contract purchaser, and in which the seller retained title until completion of payment of the contract price. The Court said:

"In *La Sala* . . . we concluded that while a lender may insist on the automatic enforcement of such a [due-on] clause upon the occurrence of an outright sale . . ., he may not exercise such an absolute power upon the further *encumbering* of the property . . . *but may enforce such clause only when enforcement is reasonably necessary to protect his security.*" (emphasis added) Tucker v. Lassen, *supra.* at 632.

The Court held that enforcement of a due-on-sale clause in an installment land sale contract was an unreasonable restraint on alienation unless necessary to protect the lender's security.

Meanwhile, *Wellenkamp v. Bank of America* was proceeding through the California courts. It presented, again, the issue which had been decided in *Coast Bank,* and confirmed in *Jones, Cherry, Hellbaum,* and *La Sala,* namely: whether a lender could "automatically" accelerate under a due-on-sale clause where there was an outright sale.

The opinion in *Wellenkamp v. Bank of America,* 21 Cal.3d 943 (1978) is attached as Appendix C.

The decision overruled *Coast Bank,* disapproved *Jones, Cherry, Hellbaum* and held that a lender could enforce a due-on-sale clause in the event of an outright sale only where enforcement was necessary to protect the lender's security.

The effect of the decision was to alter the terms of the note and allow the borrower home-owner to sell his loan and interest rate and thereby facilitate the sale of his home *at his price,* rather than at the lower price which rising interests rates would have forced on him had he owned his home free and clear.

Addressing the question presented in this Petition, the California Supreme Court said:

"It is urged that our decision should be given a purely prospective effect, given the reliance on existing laws by lenders when they entered into long-term real estate loan contracts. 'It is the general rule that a decision of a Court of

Supreme Jurisdiction overruling a former decision is retrospective in its operation' . . . We see no reason to depart from this rule in this case merely because of the lenders' expectations that they would derive economic benefits from enforcement of the due-on-clause." Wellenkamp v. Bank of America, *supra* at 955-956.

In these words the California Supreme Court (1) recognized that long-term real estate loan contracts had been made by lenders in reliance upon existing substantive contract and property law and in the expectation of economic gain to be derived from the due-on-sale clause used in accordance with existing substantive contract and property law, (2) overruled existing substantive contract and property law and (3) applied the new substantive law retroactively to deny the economic expectations on the basis of which the lenders made the contracts on faith in existing substantive law.

The Court then said:

"However, given the importance of the stability of real estate titles and the interest in preserving completed real estate financing arrangements, we hold that this decision shall not apply when the lender, prior to the date that this decision becomes final, has either enforced the due-on clause, resulting in sale of the subject property by foreclosure or in discharge of the accelerated debt, or when the lender has waived enforcement of the due-on clause in return for an agreement with the new buyer modifying the existing financing." Wellenkamp v. Bank of America, *supra* at 954.

Petitioner immediately took the steps necessary to permit the foreclosure proceedings, which it had commenced in 1970, to be completed on September 22, 1978, prior to September 29, 1978, the date on which the decision in *Wellenkamp* would become final.

Concurrently, on August 29, 1978, Petitioner moved for Summary Judgment.

On September 14, 1978, Respondents filed an Application for Order to Show Cause and Temporary Restraining Order restraining sale.

On September 14, 1978, the Trial Court granted a Temporary Restraining Order, setting the matter for hearing September 29, but imposing the condition:

> "That if a preliminary injunction is not issued, then the date of sale shall be considered the initially scheduled date of September 22, 1978."

On November 7, 1978, the Trial Court announced its ruling granting the Motion for Summary Judgment continuing the preliminary injunction in effect upon the original terms and conditions until final action by the United States Supreme Court in *Garfinkle v. Superior Court, supra.*

On November 14, 1978, the Trial Court entered Summary Judgment of Dismissal of this action, as of September 14, 1978, and ordered that any sale under the Trust Deed be deemed to have occurred on September 22, 1978, the date initially scheduled for sale.

The Garfinkles petitioned to the California Court of Appeal for Mandamus. On March 5, 1979, the California Court of Appeal rendered its decision to issue a Mandate to the Contra Costa Superior Court to set aside its Order granting Summary Judgment for Real Parties and to set aside those portions of its Restraining Order of September 14, 1978, amended October 13, 1978, and Preliminary Injunction of November 7, 1978, which condition issuance upon "deeming the date of sale to be September 22, 1978."

On May 3, 1979, the California Supreme Court deemed timely Petition for Hearing.

In this way, Petitioner's contract and property rights have been taken and impaired by changes in the law of contracts and

property made by the State of California, acting through its Courts.

REASONS FOR GRANTING THE WRIT

This Court has held that State court action is state action for Fourteenth Amendment purposes and that a state may not through its courts deny rights guaranteed by the Fourteenth Amendment.

Brinkerhoff-Faris Co. v. Hill, 281 U.S. 673 (1930); *Shelley v. Kraemer,* 334 U.S. 1 (1948); *Barrows v. Jackson,* 346 U.S. 249 (1953).

This Court has repeatedly held that retroactive application of new case law to contracts made on the faith of earlier contrary case law, does not deny due process under the Fourteenth Amendment, although the same action if taken by the legislature would do so.

Tidal Oil Co. v. Flanagan, 263 U.S. 444 (1924); *Barrows v. Jackson, supra; Shelley v. Kraemer, supra; Stockholders v. Sterling,* 300 U.S. 175 (1937); *Hawks et al., v. Hamill, et al.,* 288 U.S. 52 (1933); *Gt. Northern Ry. v. Sunburst Co.,* 287 U.S. 358 (1932); *Fleming v. Fleming,* 264 U.S. 29 (1924); *Brinkerhoff-Faris Co. v. Hill, supra.*

To make new law applicable retroactively to destroy rights acquired on the faith of formerly well-settled law, is the essense of government by men, not law. It is a manner of government rejected by our society, as well as by our law, because it is unfair.

The dilemma presented in allowing the courts to make law retroactive where the legislature cannot do so, needs explanation.

It is explained by the same Court which decided *Tidal Oil Co. v. Flanagan, supra*:

> "The effect of the subsequent decisions is not to make a new law but only to hold that the law always meant what the Court now says it means." *Fleming v. Fleming, supra.* at 31, 32.

This explanation is myth, as has been recognized:

> "[A] change of judicial decision after a contract has been made on the faith of an earlier one the other way is a change of the law." Holmes, J. dissenting in *Kuhn v. Fairmont Coal Co.*, 215 U.S. 349, 371 (1910).

The myth was abandoned by this Court 15 years ago. *Linkletter v. Walker,* 381 U.S. 618, 622-629 (1965). This Court no longer indulges in "the fiction that the law now announced has always been the law." *Chevron Oil Co. v. Huson,* 404 U.S. 97, 107 (1971).

Recognition of error in the reason for a rule is recognition of error in the rule.

If state action changing the law of contract or property on the faith of which contracts were earlier made denies due process under the Fourteenth Amendment, it makes no difference to the Constitution or the victim of the change, whether the change is made by the state legislature or the state court.

This petition should be granted to permit this Court to consider these realities and conform its jurisdiction to them.

Assuming, then, that state court action is subject to the same Constitutional limitation applicable to state legislative action, we proceed.

Enforcement of new law to invalidate contracts made on the faith of old law under which the contracts were valid impairs the obligation of contracts as a matter of fact. The courts have recognized that this is so.

> "Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid. *Contributors to Pennsylvania Hospital v. Philadelphia,* 245 U.S. 20 (1917); see *El Paso v. Simmons,* 379 U.S. 497, 533-534 (1965) (Black, J., dissenting)." *United States Trust Company v. New Jersey,* 431 U.S. 1, 19 n. 16 (1976).

In *Ohio Life Insurance and Trust Co. v. Debolt,* 57 U.S. (16 How.) 415 (1853) this Court said:

> "Indeed, the duty imposed upon this court to enforce contracts honestly and legally made, would be vain and nugatory, if we were bound to follow *those changes in judicial decisions which the lapse of time, and the change in judicial officers, will often produce* . . . . And the sound and true rule is, that if the contract when made was valid by the laws of the State, as then expounded by all the departments of its government, and administered in its courts of justice, its validity and obligation cannot be impaired by any subsequent act of the legislature of the State, or decision of its courts, altering the contruction of the law." 57 U.S. at 432 (emphasis added).

Where a clause imposing a continuing duty, formerly found valid, is later found invalid, the clause is treated as valid up to the time when the law with respect to its validity was changed. *Bendix Corporation v. Balax, Inc.*, 471 F.2d 149, 158 (1973).

Courts therefore apply to contracts the law as it existed when the contracts were made. *Gelpcke v. Dubuque,* 1 Wall. 175 (1863), *Green County v. Conness,* 109 U.S. 104 (1883); *Linkletter v. Walker,* 381 U.S. 618, 624, 625 (1965); *Chevron Oil Co. v. Huson, supra,* 106, 107 (1971); *Alan v. County of Wayne,* 200 N.W.2d 628, 678 (Mich. 1972). These cases involve enforceability of notes or bonds, as does this case, in which the right to accelerate the note upon sale is expressed in the note itself and constitutes an integral part of the promise to pay.[2]

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2. In *Wellenkamp* the note included a due-on-sale clause. The California Supreme Court said in footnote 12:

> "Defendant argues that even if the due-on clause contained in the deed of trust were held not to be automatically enforceable because it constitutes an unreasonable restraint on alienation, inclusion of the due-on clause in the promissory note, as required by Civil Code section 2924.5 for property containing four or fewer residential units, would make that clause part of the debt itself and therefore automatically enforceable on that basis. It is clear

It was therefore improper under the Fourteenth Amendment of the United States Constitution for the California Court of Appeal to apply to this case the decision of the California Supreme Court in *Wellenkamp,* and thereby invalidate a contract which was lawful when it was made.

The impropriety of the decision becomes magnified considering that in 1976, the California legislature enacted the provisions of Civil Code Section 2924.6.[3] The legislature thereby considered the subject of due-on-sale clauses and decided to what extent their use should be curtailed.[4] The legislature recognized its obligation under Amendments 10 and 14 to the United States Constitution to refrain from making changes in the law regarding due-on-sale clauses applicable to old contracts.

The California Court decision of which we seek review applied to an old contract a Court decision which changed the law of contracts and exercised no such restraint.

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that the purpose of Civil Code section 2924.5 is to provide notice to the borrower; it cannot be reasonably interpreted in the manner that defendant suggests."

Civil Code Section 2924.5 was enacted in 1971. It was not in effect in 1967 when the note in this case was signed.

3. These provisions are set out in Appendix D.

4. Concerning the thought that in so doing the Legislature had "occupied the field", the California Supreme Court, in *Wellenkamp, supra,* said in footnote 13:

> "We reject defendant's contention that Civil Code section 2924.6, which prohibits acceleration after the events listed therein, sanctions acceleration in other situations not specifically mentioned in that legislation. The Legislature, in enacting section 2924.6, expressly disclaimed any such intent: 'This act is not intended to affect the application of any other provision or principle of law to any type of acceleration provision *other than those specifically described in this act.*" (Stats. 1975, ch. 850, § 2.) (Emphasis added.)"

The legislative disclaimer concerns types of acceleration provisions "other than those described in this act". The acceleration clause in Petitioner's Note *is* of the type described in Civil Code Section 2924.6, but was signed in 1967, eight years before Civil Code Section 2924.6 was enacted.

The United States Constitution guarantees to United States citizens only that state government be Republican, no more, Article IV, Section 4. It may not guarantee separation of powers, so that states may make changes in the law of contract as freely by their courts as by their legislatures. All the more should United States citizens receive under the Fourteenth Amendment the protection from court-made changes in the law to which they are entitled from legislature-made changes in the law.

CONCLUSION

It is now timely for this Court to review the extent to which the State Courts themselves are subject to United States Constitutional restraint.

We submit that this Petition presents an ideal vehicle for such a review.

Dated: July 27, 1979

Respectfully submitted,
DAVID W. LENNIHAN

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Appendix A

FILED

Mar—5 1979

Court of Appeal—First App. Dist.
CLIFFORD C. PORTER, Clerk

By.....
Deputy

In the Court of Appeal of the State of California
First Appellate District, Division Three

1 Civil 45643
(Sup. Ct. No. 143399)

SUSAN GARFINKLE and GARY GARFINKLE,
Petitioners,

vs.

SUPERIOR COURT, CONTRA COSTA COUNTY,
Respondent,

WELLS FARGO BANK, et al.,
Real Parties in Interest.

The issue raised by this petition is whether the filing of the decision in *Wellenkamp v. Bank of America* (1978) 21 Cal.3d 943 on August 25, 1978 justified a subsequent trial court decision permitting Wells Fargo Bank to enforce the due-on-sale clause in its deed of trust with petitioners' predecessor in interest.

Prior to the filing of the *Wellenkamp* decision, the trial court had taken the position that a cause of action had been stated by petitioners' allegation of wrongful exercise of the due-on-sale clause of the deed of trust. The *Wellenkamp* decision affirmed petitioners' and the trial court's view of the due-on-sale clause. But it also stated a rule of retrospectivity which formed the basis for the trial court's further actions.

In the words of the court:

"It is urged that our decision should be given a purely prospective effect, given the reliance on existing laws by lenders when they entered into long-term real estate loan contracts. 'It is the general rule that a decision of a court of supreme jurisdiction overruling a former decision is retrospective in its operation . . . .' [citation] We see no reason to depart from this rule in this case merely because of the lenders' expectations that they would derive economic benefits from enforcement of the due-on clause. [citation] However, given the importance of the stability of real estate titles and the interest in preserving completed real estate financing arrangements, we hold that this decision shall not apply when the lender, prior to the date that this decision becomes final, has either enforced the due-on clause, resulting in sale of the subject property by foreclosure or in discharge of the accelerated debt, or when the lender has waived enforcement of the due-on clause in return for an agreement with the new buyer modifying the existing financing." (*Wellenkamp v. Bank of America* (1978) 21 Cal.3d 943, 953, 954.)

After the *Wellenkamp* decision was announced, but before it became final, Wells Fargo noticed a trustee's sale to be conducted on September 22, 1978 and moved for summary judgment on petitioners' complaint, asserting that the foreclosure would prevent application of *Wellenkamp's* ruling on the merits. Petitioners sought a preliminary injunction against the sale. They obtained a restraining order, but only on the condition that if the injunction were ultimately denied the date of sale would be deemed to be September 22, 1978. The court ultimately granted summary judgment for Wells Fargo and issued an order having the effect of denying petitioners' request for an injunction.

It is clear from the sequence of events that the trial court's rulings were based upon the *Wellenkamp* court's announcement about retrospectivity. However, in light of the results reached by the trial court, it is also clear that the court did not follow *Wellenkamp's* ruling on the merits. The effect of the court's action was to apply different rules of finality to the substantive and retrospectivity rulings of the *Wellenkamp* court. In the trial court's view the ruling on the merits became effective only on the date the decision became final, but its ruling on retrospectivity deserved respect even though not final.

A trial court may not pick and choose between parts of a non-final decision to apply. The injustice of allowing such a procedure is dramatically illustrated by this case. Petitioners (unlike Cynthia Wellenkamp) had convinced the trial court that they could state a cause of action for improper use of a due-on-sale clause. There was no impending threat that the due-on-sale clause would be exercised.[1] The *Wellenkamp* decision should have solidified petitioners' position. Instead, it was used to defeat them.

The *Wellenkamp* court picked the date of its decision's finality rather than the date of its filing as the cut-off date for exercise of due-on-sale clauses for the obvious reason that foreclosures in progress or which would have occurred before the decision became final should not be prevented by a non-final decision. It is another matter to apply the retrospectivity ruling to justify a foreclosure which would not have taken place without the *Wellenkamp* decision. In the former case the non-final decision is not allowed to intrude upon actions already in progress. This is proper since the decision may be changed or nullified by rehearing. In the latter case though, the non-final decision is read as if it were final, prematurely applying a retrospectivity rule which might itself be changed by a grant of rehearing. The non-final decision intrudes with a force it should not be permitted to wield during the rehearing time.

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1. They had Wells Fargo Bank's agreement that it would not foreclose pending litigation. And even if that agreement were narrowly interpreted to apply only to litigation of other points in the lawsuit, petitioners stood a good chance of obtaining an injunction in light of the fact that their complaint had withstood a demurrer.

We are convinced that the trial court erred in conditioning its restraining order upon deeming the sale to have taken place on September 22, 1978. Foreclosure should have been restrained without condition, and summary judgment for the bank therefore denied. We have reached this conclusion after a full briefing by the parties. An alternative writ would add nothing to the presentation already made. A peremptory writ is proper (Code Civ. Proc., § 1088; *San Diego Wholesale Credit Men's Assn. v. Superior Court* (1973) 35 Cal.App.3d 458; *Goodenough v. Superior Court* (1971) 18 Cal.App.3d 692, 697) and should issue.

Let peremptory writ of mandate issue directing the Contra Costa County Superior Court to set aside its order granting summary judgment for real parties and to set aside those portions of its restraining order of September 14, 1978, amended October 13, 1978 and preliminary injunction of November 7, 1978 which condition issuance upon deeming the date of sale to be September 22, 1978.

.....

White, P.J.

WE CONCUR:

.....

Scott, J.

.....

Feinberg, J.

Appendix B

CLERK'S OFFICE, SUPREME COURT
4250 State Building
SAN FRANCISCO, CALIFORNIA 94102

MAY 3 1979

I have this day filed Order

HEARING DENIED

In re: 1 Civ *No.* 45643

Garfinkle

vs.

Sup. Ct. Contra Costa
Wells Fargo et al)

Respectfully,

G. E. BISHEL
Clerk

Appendix C

SEE DISSENTING OPINION

SUPREME COURT
FILED
AUG 25 1978
G. E. BISHEL, Clerk
Deputy

COPY

In the Supreme Court of the State of California

L. A. 30776

Super. Ct. No. 15974

CYNTHIA J. WELLENKAMP,
Plaintiff and Appellant,

v.

BANK OF AMERICA et al.,
Defendants and Respondents.

We address today the question whether enforcement of a due-on clause,[1] contained in a deed of trust securing real property, upon an outright sale of that property, constitutes an unreasonable restraint on alienation in violation of California law.

In July 1973, Birdie, Fred and Dorothy Mans (Mans) purchased a parcel of real property in Riverside County which they financed by a loan from defendant Bank of America in the amount of $19,100 (at 8 percent interest per annum) giving the

1. A due-on clause is a device commonly used in real property security transactions to provide, at the option of the lender, for acceleration of the maturity of the loan upon the sale, alienation or further encumbering of the real property security.

bank their promissory note secured by a deed of trust. The deed of trust contained the standard due-on clause which provided that if the trustor (the Mans) "sells, conveys, alienates . . . said property or any part thereof, or any interest therein . . . or becomes divested of [his] title or any interest therein . . . in any manner or way, whether voluntarily or involuntarily, . . . Beneficiary shall have the right at its option, to declare said note . . . secured hereby . . . immediately due and payable without notice. . . ." The Mans' deed of trust named defendant Continental Auxiliary Company as trustee.

In July 1975, plaintiff Cynthia Wellenkamp purchased the property from the Mans. She paid the Mans the amount of their equity in the property, that is, the difference between the total selling price to plaintiff and the balance outstanding on the Mans' loan, and agreed with the Mans to assume the balance of their loan from defendant. A grant deed, transferring title to plaintiff was recorded on July 10, 1975. Defendant bank (hereinafter defendant) was given prompt notice of the transfer of title to plaintiff as well as her check for the July payment on the Mans' loan. Defendant thereupon returned this check to plaintiff with a letter notifying her of its right to accelerate upon transfer of the property by the Mans. The letter offered to waive defendant's right to accelerate in return for plaintiff's agreement to assume the Mans' loan at an increased rate of interest (from the original 8 percent to 9¼ percent per annum). A printed assumption agreement was enclosed with defendant's letter for plaintiff's signature.

Upon plaintiff's failure to accede to defendant's demand that the interest on the loan be raised to the then current rate, defendant filed a notice of default and election to sell under the deed of trust.

Plaintiff then filed the present action in which she sought an injunction against enforcement of the due-on clause, and a dec-

laration that exercise of such a clause, without any showing that defendant's security had been impaired as a result of the sale of the property to plaintiff, constituted an unreasonable restraint on alienation in violation of California law.

After the superior court granted plaintiff's motion for a preliminary injunction restraining defendant's foreclosure sale of the property, defendant demurred to plaintiff's complaint on the ground that it failed to state facts sufficient to constitute a cause of action for declaratory relief because automatic enforcement of a due-on clause after transfer of the property in an outright sale is valid under California law, and therefore, plaintiff could not prevail on the merits. After a hearing the superior court sustained the general demurrer, without leave to amend, and entered a judgment dismissing plaintiff's complaint.[2] This appeal followed.

A complaint for declaratory relief is legally sufficient if it sets forth facts showing the existence of an actual controversy relating to the legal rights and duties of the parties under a written instrument or with respect to property and requests that the rights and duties of the parties be adjudged by the court. (Code Civ. Proc., § 1060; Maguire v. Hibernia Sav. and Loan Soc. (1944) 23 Cal.2d 719.) If these requirements are met and no basis for declining declaratory relief appears, the court should declare the rights of the parties whether or not the facts alleged establish that the plaintiff is entitled to favorable declaration. (Bennett v. Hibernia Bank (1956) 47 Cal.2d 540, 550; Columbia Pictures v. DeToth (1945) 26 Cal.2d 753.)

The complaint herein alleges a controversy over the legal rights and duties of plaintiff and defendant under the deed of

2. In April 1976 the parties filed a stipulation for deferring foreclosure, whereby defendant agreed to refrain from taking further action to foreclose the deed of trust during the pendency of this appeal and plaintiff agreed to pay defendant the amount of the monthly payments on the Mans' loan.

trust containing a due-on clause. Plaintiff contends that this clause is unenforceable absent a showing by the lender of impairment to its security; whereas defendant contends that it can automatically enforce the clause without any further showing. It is clear that the complaint shows the existence of an actual controversy sufficient to state a cause of action for declaratory relief. Therefore, the trial court committed error when it tested the sufficiency of the complaint by a determination of the merits and sustained the demurrer on the ground that no cause of action for declaratory relief had been stated. Defendant urges that, notwithstanding this procedural error by the trial court, judgment of dismissal should nonetheless be affirmed on appeal because plaintiff would not be entitled to a favorable declaration on remand. Defendant bases this proposal on its contention that automatic enforcement of the due-on clause after transfer of the subject real property in an outright sale does not constitute an unreasonable restraint on alienation. We do not agree.

We begin our discussion with a summary of the California law on restraints on alienation. Civil Code section 711 sets forth the basic law on the subject and states simply that "conditions restraining alienation, when repugnant to the interest created, are void." Our decision in Coast Bank v. Minderhout (1964) 61 Cal.2d 311, recognized that this rule was not absolute in its application, but forbade only *unreasonable* restraints against alienation. In determining whether a due-on clause was unreasonable in *Coast Bank* we looked at whether the restraint was necessary to prevent impairment to the lender's security. We conclude that the restraint was reasonable in that case.

We next had occasion to determine whether a given restraint was unreasonable within the meaning of *Coast Bank* in La Sala v. American Sav. and Loan Assn. (1971) 5 Cal.3d 864. The restraint involved in *La Sala* was a due-on clause which provided

for acceleration of the maturity of the loan upon encumbrance of the subject property. In determining whether enforcement of this clause constituted an unreasonable restraint on alienation, we considered not only whether the restraint was necessary to prevent impairment to the lender's security, but also the effect that enforcement of the restraint would have on alienation. We concluded that enforcement of a due-on clause upon encumbrance of the subject property involved a significant restraint on alienation such as to preclude enforcement of the clause unless the lender could show that enforcement was reasonably necessary to protect its security.

Three years later, in Tucker v. Lassen Sav. & Loan Assn. (1974) 12 Cal.3d 629, we confronted the question whether automatic enforcement of a due-on clause upon the sale of the subject property by installment contract constituted an unreasonable restraint against alienation. Examining the principles developed in *La Sala* we recognized that a direct relationship exists between the *justification* for enforcement of a particular restraint on the one hand, and the *quantum of restraint*, the actual practical effect upon alienation which would result from enforcement, on the other. Thus, the greater the quantum of restraint that results from enforcement of a given clause, the greater must be the justification for that enforcement. Applying this test in Tucker v. Lassen Sav. & Loan Assn., *supra*, 12 Cal.3d 629, we concluded that enforcement of a due-on clause upon sale of the property by installment contract involved a high quantum of restraint requiring a significant showing that enforcement was necessary to protect the lender's security.

We now proceed to apply the principles set forth in *La Sala* and *Tucker* to the case at bench which presents the issue, stated at the outset of this opinion, whether a due-on clause contained

in a promissory note or deed of trust may be automatically enforced upon an outright sale of the property securing the loan.[3]

We first discuss the *quantum of restraint* imposed by enforcement of the due-on clause after transfer of the property by outright sale, for if, as defendant contends, automatic exercise of the clause in these circumstances results in little, if any, restraint on alienation, we need not reach the question whether there exists justification sufficient to warrant enforcement.

Although we suggested in *dicta* in both *Tucker* and *La Sala* that the restraint on alienation resulting from acceleration after an outright sale appeared to be de minimis, we indicated in those decisions that by the term "outright" sale, we were referring to transactions wherein the seller/trustor received full payment from the buyer, usually through new financing of the purchase (an "all cash to seller" sale). We reasoned that the restraint on alienation was slight in such cases because the seller received payment sufficient to discharge the balance of the loan secured by the deed of trust,[4] whereas in cases involving junior encumbrances or installment land contracts, the seller normally received only a fraction of the balance outstanding on the loan.

We do not here so restrict the meaning of the term "outright sale," but instead, and in accordance with actual real estate parlance, we refer by that term to any sale by the trustor of property wherein legal title (and usually possession) is transferred.

Outright sales of real property commonly involve different types of financing arrangements depending upon the circum-

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3. We note that there are a number of decisions in other jurisdictions which reach differing results on the question whether a due-on clause can be automatically enforced upon the occurrence of an outright sale of the subject property. A lengthy discussion of these decisions is unnecessary, however, as we feel that our own decisions in *Tucker* and *La Sala* provide both an adequate and appropriate basis for determining what the law is in California on this question.

4. Indeed, in substantially all cases herein new financing is obtained the escrow instructions will contemplate direct payment of the existing loan balance to the lender.

stances existing at the time of sale. Thus, when new financing is available and economically feasible, a buyer will be able to arrange to pay the seller the purchase price in full, in an "all cash to seller" arrangement. When, however, new financing is unavailable or is economically unfeasible, the buyer may arrange, as did plaintiff herein, to pay the seller only the amount of the seller's equity in the property, agreeing to assume or take "subject to" the existing deed of trust, in a "cash to loan" arrangement.[5]

The availability of new financing often depends upon general economic conditions. In times of inflation, when money is "tight" and funds available for real estate loans are in short supply, new financing may be difficult, if not impossible to obtain. The same result may occur when interest rates and the transactional costs of obtaining new financing are high, making it economically unfeasible for the buyer to acquire a new loan. When economic conditions are such that new financing is either unavailable or economically unfeasible, the seller and buyer will normally agree to a form of financing arrangement wherein the buyer will assume the seller's loan. In such circumstances, if the lender is unwilling to permit assumption of the existing loan, and instead elects to enforce the due-on clause, transfer of the property may be prohibited entirely, because the buyer will be unable to substitute a new loan for the loan being called due, and the seller will not receive an amount from the buyer sufficient to discharge that loan, particularly when the balance due is substantial. (See 1 Miller & Starr, Current Law of Cal. Real Estate, pt. 1 (1975 ed.) § 3:65, pp. 435-436.) Even when the lender is willing to waive its option to accelerate in return for the assumption of the existing loan at an increased interest rate, an inhibitory effect

5. Other financing arrangements that may be utilized in these circumstances include transactions wherein the seller takes back a second deed of trust or an "all-inclusive" deed of trust.

on transfer may still result. The buyer, faced with the lender's demand for increased interest, may insist that the seller lower the purchase price. The seller would then be forced to choose between lowering the purchase price and absorbing the loss with the resulting reduction in his equity interest,[6] or refusing to go through with the sale at all. In either event, the result in terms of a restraint on alienation is clear.[7] (See Note, *Judicial Treatment of the Due-On-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability* (1975) 27 Stan. L.Rev. 1109, 1113.)

It is against this effect on alienation that we must measure the factors advanced in justification. In *Tucker* we held that a restraint on alienation could be justified only when a legitimate interest of the lender was threatened. We indicated that such interests, which pertain to protection against impairment to the lender's security, included preservation of the security from waste or depreciation and protection against the "moral risks" of having to resort to the security upon default by an uncreditworthy buyer. (See Hetland, *Real Property and Real Property Security: The*

6. A state policy that home equities are to be protected and conserved is set forth in Health and Safety Code section 50007 (formerly § 41007).

7. The argument of the dissent—that our holding places the seller of encumbered real property at a "competitive advantage" over the seller of unencumbered real property in periods of rising interest and tight money—simply misses the point. The fact that market conditions may operate to hamper the sale of some real property during such periods certainly cannot be held to justify the hampering of all such sales regardless of whatever financing arrangements may be outstanding against such property. Sellers of unencumbered real property have presumably benefited from lower interest rates in achieving their position. To require sellers of encumbered real property, who have not enjoyed this benefit, to suffer from market contingencies along with those who have, is to take a very narrow view of "competitive advantage." In any event we here concern ourselves with the effect of due-on provisions in the sale of properties subject to existing financing—not with the effect of market conditions upon properties not subject to existing financing. To the extent that such clauses hamper alienation of properties in the former category, a restraint upon alienation occurs.

Well Being of the Law (1965) 53 Cal.L.Rev. 151, 170; see also Cal. Real Estate Secured Transactions (Cont.Ed.Bar 1970) § 4.56, p. 184.)

Defendant contends that the risk of waste and default is significant in an outright sale because both possession and legal title to the property are transferred, thereby eliminating any incentive or ability that the seller/trustor would have to avoid realization of these risks by action of the buyer. Although we have previously distinguished on this basis both the junior encumbrance, where neither possession nor legal title was transferred (*La Sala*) and the installment land contract, where possession but not legal title was transferred (*Tucker*), we are now convinced that, although the original borrower/seller no longer retains an interest in the property after transfer of legal title in an outright sale involving no secondary financing by the seller (see fn. 5, *ante*)[8] this fact does not necessarily increase the risk to the lender that waste or default will occur. Thus the buyer in an outright sale, in order to pay off the seller's equity, may make a large down payment on the property, thereby creating an equity interest in the property *in him* which is sufficient to provide an adequate incentive not to commit waste or permit the property to depreciate. Moreover, the buyer in such an outright sale may be at least as good, if not a better credit risk than the original borrower/seller. We therefore conclude that although circumstances may arise in which the interests of the lender may justify the enforcement of a due-on clause in the event of an

8. When the seller does not receive the value of his equity in cash but takes back a second or "all-inclusive" deed of trust for a portion thereof, he of course retains an equity interest in the property which provides him with an incentive to prevent waste or default. In this case, then, both the buyer and the seller have an interest in preserving the security. The lender's position thus resembles that occupied by it in the context of an installment land sale contract. (See 1 Miller & Starr, Current Law of California Real Estate, pt. 1, *supra*, § 3:65, pp. 439-440, fns. 15 and 16 and accompanying text.)

outright sale, the mere fact of sale is not in itself sufficient to warrant enforcement of the clause, and the restraint on alienation resulting therefrom, in the absence of a showing by the lender that such circumstances exist.[9]

We furthermore reject defendant's contention that the lender's interest in maintaining its loan portfolio at current interest rates justifies the restraint imposed by exercise of a due-on clause upon transfer of title in an outright sale. Although we recognize that lenders face increasing costs of doing business and must pay increasing amounts to depositors for the use of their funds in making long-term real estate loans as a result of inflation and a competitive money market, we believe that exercise of the due-on clause to protect against this kind of business risk would not further the purpose for which the due-on clause was legitimately designed, namely to protect against impairment to the lender's security that is shown to result from a transfer of title.[10] Economic risks such as those caused by an inflationary economy are among the general risks inherent in every lending transaction. They are neither unforeseeable nor unforeseen. Lenders who provide funds for long-term real estate loans should and do, as a matter of business necessity, take into account their projections of future economic conditions when they initially determine the rate of payment and the interest on these long-term loans. (See Note, *Judicial Treatment of the Due-On Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*,

9. In the instant case the party seeking enforcement of the due-on clause is an institutional lender. We limit our holding accordingly. We express no present opinion on the question whether a private lender, including the vendor who takes back secondary financing, has interests which might inherently justify automatic enforcement of a due-on clause in his favor upon resale.

10. Automatic enforcement of the due-on clause is not the only method by which lenders can adjust the yield from their loan portfolios to meet increases in the cost of funds for these loans. With the enactment of Civil Code section 1916.5, the variable interest rate mortgage has become an attractive and viable alternative.

supra, 27 Stan. L.Rev. at p. 1117.) Unfortunately, these projections occasionally prove to be inaccurate. We believe, however, that it would be unjust to place the burden of the lender's mistaken economic projections on property owners exercising their right to freely alienate their property through the automatic enforcement of a due-on clause by the lender.[11] As we stated in *La Sala,* ". . . a restraint on alienation cannot be found reasonable merely because it is commercially beneficial to the restrainor. Otherwise one could justify any restraint on alienation upon the ground that the lender could exact a valuable consideration in return for its waiver, and that sensible lenders find such devices profitable." (5 Cal.3d at pp. 880-881, fn. 17.)

For the foregoing reasons, we hold that a due-on clause contained in a promissory note or deed of trust[12] cannot be enforced upon the occurrence of an outright sale unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default.[13] We

11. We note that lenders have utilized the exercise of a due-on clause for other purposes in addition to maintaining their loan portfolios at current rates of interest. The clause has also been used as a lever to exact substantial consideration from the buyer in the form of assumption and waiver fees. (See Cherry v. Home Sav. & Loan Assn. (1969) 276 Cal.App.2d 574; Hellbaum v. Lytton Sav. & Loan Assn. (1969) 274 Cal.App.2d 456.)

12. Defendant argues that even if the due-on clause contained in the deed of trust were held not to be automatically enforceable because it constitutes an unreasonable restraint on alienation, inclusion of the due-on clause in the promissory note, as required by Civil Code section 2924.5 for property containing four or fewer residential units, would make that clause part of the debt itself and therefore automatically enforceable on that basis. It is clear that the purpose of Civil Code section 2924.5 is to provide notice to the borrower; it cannot be reasonably interpreted in the manner that defendant suggests.

13. We reject defendant's contention that Civil Code section 2924.6, which prohibits acceleration after the events listed therein, sanctions acceleration in other situations not specifically mentioned in that legislation. The Legislature, in enacting section 2924.6, expressly disclaimed any such intent: "This act is not intended to affect the application of any other provision or principle of law to any type of acceleration provisions other than those specifically described in this act." (Stats. 1975, ch. 850, § 2.)

therefore disapprove Hellbaum v. Lytton Sav. & Loan Assn., *supra,* 274 Cal.App.2d 456 and Cherry v. Home Sav. & Loan Assn., *supra,* 276 Cal.App.2d 574, and overrule to the extent inconsistent with this opinion the case of Coast Bank v. Minderhout, *supra,* 61 Cal. 2d 311.

It is urged that our decision should be given a purely prospective effect, given the reliance on existing laws by lenders when they entered into long-term real estate loan contracts. "It is the general rule that a decision of a court of supreme jurisdiction overruling a former decision is retrospective in its operation . . . ." (County of Los Angeles v. Faus (1957) 48 Cal.2d 672, 680-681.) We see no reason to depart from this rule in this case merely because of the lenders' expectations that they would derive economic benefits from enforcement of the due-on clause. (See Texas Co. v. County of Los Angeles (1959) 52 Cal.2d 55.) However, given the importance of the stability of real estate titles and the interest in preserving completed real estate financing arrangements, we hold that this decision shall not apply when the lender, prior to the date that this decision becomes final, has either enforced the due-on clause, resulting in sale of the subject property by foreclosure or in discharge of the accelerated debt, or when the lender has waived enforcement of the due-on clause in return for an agreement with the new buyer modifying the existing financing.

The judgment is reversed.

MANUEL, J.

WE CONCUR:

BIRD, C. J.
TOBRINER, J.
MOSK, J.
RICHARDSON, J.
NEWMAN, J.

COPY

Wellenkamp v. Bank of America
L.A. 30776

DISSENTING OPINION BY CLARK, J.

Holding that exercise of a "due-on clause" upon outright sale of real property unreasonably restrains that sale, the majority opinion either misreads or rejects the very decisions on which it relies, particularly Tucker v. Lassen Sav. & Loan Assn. (1974) 12 Cal.3d 629. Additionally, the majority opinion awards the owner of encumbered real property a bonus in that he can now sell his property for something in excess of what he could sell it for if unencumbered.

We have thus come full circle. In attempting to take away contractual rights of lenders in order to assist borrowers in selling encumbered properties, the majority opinion has devised a scheme which affords yesterday's borrower a clear advantage over today's seller who comes to the marketplace with his property free from encumbrance. But our beneficence may be shortsighted. For in attempting to assist the Wellenkamps, the majority opinion must necessarily restrict if not dry up mortgage funds otherwise available to the next generation of borrowers.

I briefly review the route by which we arrive at the threshold of today's decision. In Coast Bank v. Minderhout (1964) 61 Cal.2d 311, our unanimous court agreed that reasonable restraints on alienation of real property were lawful, and held that it was reasonable for a lender to condition its continued extension of credit to borrowers "on their retaining their interest in the property that stood as security for the debt." (*Id.*, at p. 317.)

In La Sala v. American Sav. & Loan Assn. (1971) 5 Cal.3d 864, we dealt with a due-on-encumbrance clause and distinguished *Coast Bank*. We first noted that enforcement of a due-on-sale clause as in *Coast Bank* was justified because of lender concern for a borrower's continued interest in maintaining the property, but concluded that because the creation of a junior encumbrance in the property did not terminate the borrower's continuing interest, enforcement of the due-on clause was not necessary to protect the lender. We held that enforcement of a due-on-encumbrance clause could thus be an unreasonable restraint on alienation. (*Id.*, at p. 880.) However, a near unanimous court noted that if particular circumstances indicated the lender's security was endangered "the enforcement of the due-on-encumbrance clause may be reasonably necessary . . ." (*id.*, at p. 881), relying on *Coast Bank* (*id.*, at p. 882).

Finally, in Tucker v. Lassen Sav. & Loan Assn., *supra*, 12 Cal.3d 629, we dealt with a due-on clause in the context of a proposed installment sale contract. We reviewed the existing law, refined the rules announced in *Coast Bank* and *La Sala* and proclaimed that the reasonableness of a restraint on alienation is to be measured by balancing the quantum of resulting restraint when a borrower is forced to comply with a due-on clause, against the justification for the restraint, that is, the measure of the hazard to the lender's security should the property be alienated as proposed. We unanimously concluded that the restraint was not reasonably justified when weighed against the quantum of restraint imposed on the borrower in an installment sale context. But as in *La Sala* we reaffirmed *Coast Bank* by demonstrating decreased justification for—and increased quantum of restraint in—an installment sale when compared with an outright sale. (*Id.*, at p. 638.)

The majority opinion now proposes to abandon what *Coast Bank*, *La Sala* and *Tucker* have taught us. Having recognized the due-on clause in junior encumbrances and installment sales to constitute unreasonable restraints *only* because they were deemed to require striking a *different* balance from that in an outright sale, the majority opinion leaps to the conclusion that a due-on

clause in an outright sale is unenforceable, thus obliterating our prior distinction.

While the majority opinion purports to weigh justification for restraint against quantum, it errs by failing to accurately weigh relevant factors. It first recognizes that if "automatic exercise of the clause in these circumstances results in litle, if any, restraints on alienation, we need not reach the question whether there exists justification sufficient to warrant enforcement." (*Ante,* p. 949.) It then purports to weigh the restraint which may result to the seller. In doing so, it must guess the marketplace. It imagines a market condition whereby money is "tight" or unavailable, and lenders are reluctant to loan except at interest rates higher than that at which the seller is obligated on an older existing loan. Exercise of a due-on clause in such circumstances, the opinion argues, restrains the seller because he cannot sell except by taking cash or a note for his "equity." If the lender is unwilling to permit assumption of its loan at the original interest rate, the seller is unreasonably restrained from selling his house. So it is argued.

What the majority opinion fails to recognize is that the "restraint" in its hypothetical case results not from exercise of the contractual clause but rather from the bleak and unpredictable economic conditions it paints. Of course, whenever money is tight and interest rates are high, a brake on those sales requiring financing naturally results.[1] A seller possessing property and a buyer lacking sufficient funds can seldom do business if financing is unavailable. It may be they cannot do business at all because

1. If the sale does not require outside financing, there is no problem as there is money available to retire the outstanding loan. The majority opinion also recognizes there is no problem when a tight money market does not exist: "Thus, when new financing is available and economically feasible, a buyer will be able to arrange to pay the seller the purchase price in full, . . ." (*Ante*, p. 950.)

of the seasonal unavailability of funds to the prospective buyer.[2] If they can do business other than by a contract of sale it follows that the buyer must pay the going interest rate and the seller, as an incentive to the buyer, may be required to reduce the selling price. If a loan exists on the property with a due-on clause, no *increased* restraint on selling results if the lender cannot accept the proposed buyer, the situation then being the same as in the case of the unavailability of funds to the proposed buyer. If the lender will permit assumption but only at an increased interest rate, again no *increased* restraint results because without the existing loan the buyer would be required to pay the higher interest rate and the seller may be required to compromise his selling price. There is thus no increased restraint on alienation beyond that inherent in the economic conditions postulated by the majority. But is it the province of this court to predict the unpredictable?

The net result of the majority opinion is best illustrated by analyzing the real effect on all parties upon denying the lender its contractual right to exercise a due-on clause. As we have noted, in a tight money market, the seller of unencumbered real property is already seriously handicapped. However, if his neighbor's home possesses an existing loan with a now unenforceable due-on clause, that seller is granted an immediate competitive advantage. In spite of his original agreement, he can now "sell" the loan without regard to the lender's wishes. His buyer has automatic financing where none is otherwise available. The interest he will be required to pay is less than market. Because that seller has a marketable, sought-after asset in the form of a low-interest transferable loan—something he never bargained for—he can ask for and expect to get additional considerations from his buyer. And the buyer may also look forward to the same

2. They could, of course, do business by a contract of sale. (Tucker v. Lassen Sav. & Loan Assn. (1974) 12 Cal. 3d 629.)

advantage on resale. The loan has thus become not a restraint on alienation but a factor making salable what before could not be sold.[3]

The majority opinion, after declaring the due-on clause imposes a serious restraint in the circumstances it postulates, proceeds to negate justification. It declares that factors this court has unanimously deemed to justify exercise of the clause in the past are of little consequence now. It acknowledges that we have—up to now—held that a lender could exercise a due-on clause on an outright sale to protect interests "which pertain to protection against impairment to the lender's security, included preservation of the security from waste or depreciation and protection against the 'moral risk' of having to resort to the security upon default by an uncreditworthy buyer. (See Hetland, *Real Property and Real Property Security: The Well Being of the Law* (1965) 53 Cal.L.Rev. 151, 170; see also Cal. Real Estate Secured Transactions (Cont.Ed Bar (1970) § 4.56, p. 184)" (*Ante*, p. 951.) However, the opinion dismisses such recognized usage with the gratuitous comment that "we are now convinced that, although the original borrower/seller no longer retains an interest in the property after transfer of legal title in an outright sale . . . this

3. The majority cling to the thesis that its decision today serves to eliminates restraints on alienation. However, in footnote 7 (*ante*, p. 951.) it concedes its concern *only* for properties with existing financing to the disadvantage of unencumbered properties, when such properties are competing on the same market. In an attempt to justify its lack of equal concerns, it argues that sellers of unencumbered real property "have presumably benefitted from lower interest rates in achieving their position," and now such advantage should be balanced in favor of those who have not benefited, they being the sellers of encumbered real property. The presumption by the majority is completely gratuitous—nothing in the record nor in sound reason supports it. The declared policy is manifestly one which would be better left to our Legislature.

fact does not necessarily increase the risk to lender that waste or default will occur." (*Ante*, pp. 951-952.) The majority refers to no authority in support of its conclusion that the mere fact of an outright sale "is not in itself sufficient to warrant enforcement" of a due-on clause "in the absence of a showing by the lender that such circumstances exist." (*Ante*, p. 952.)

The lack of citation to authority in support of the majority's conclusion is understandable in view of its purported but inaccurate application of principles enunciated in Tucker v. Lassen Sav. & Loan Assn., *supra*, 12 Cal.3d 629. In justification for holding a due-on clause unenforceable on sale of property by installment contract, the unanimous *Tucker* court stated: "Thus in the normal case the vendor, having received a small down payment and restraining legal title, has a considerable interest in maintaining the property until the total proceeds under the contracts are received; *in this he differs markedly from the vendor of property where there has been an outright sale.*" (Tucker v. Lassen Sav. & Loan Assn., *supra*, 12 Cal.3d 629, 638; italics added.)

The majority opinion errs first in concluding that a due-on clause unreasonably restricts outright sale of property; errs again in concluding there is little or no justification for the clause, contrary to our earlier holdings. We err again in failing to recognize that lenders and borrowers, owners and prospective owners, should be allowed to run their own affairs with minimal governmental intrusion—particularly from this branch.

CLARK, J.

Appendix D

§ 2924.6. [Acceleration: Prohibitions Applicable to loans executed after January 1, 1976]

(a) An obligee may not accelerate the maturity date of the principal and accrued interest on any loan secured by a mortgage or deed of trust on residential real property solely by reason of any one or more of the following transfers in the title to the real property:

(1) A transfer resulting from the death of an obligor where the transfer is to the spouse who is also an obligor.

(2) A transfer by an obligor where the spouse becomes a coowner of the property.

(3) A transfer resulting from a decree of dissolution of the marriage or legal separation or from a property settlement agreement incidental to such a decree which requires the obligor to continue to make the loan payments by which a spouse who is an obligor becomes the sole owner of the property.

(4) A transfer by an obligor or obligors into an inter vivos trust in which the obligor or obligors are beneficiaries.

(5) Such real property or any portion thereof is made subject to a junior encumbrance or lien.

(b) Any waiver of the provisions of this section by an obligor is void and unenforceable and is contrary to public policy.

(c) For the purposes of this section, "residential real property" means any real property which contains at least one but not more than four housing units.

(d) This act applies only to loans executed or refinanced on or after January 1, 1976.

Added Stats 1975 ch 850 § 1.

Note—Stats 1975 ch 850 also provides: § 2. This act is not intended to affect the application of any other provision or principle of law to any type of acceleration provision other than those specifically described in this act.

Supreme Court, U. S.
FILED
NOV 23 1979
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

No. 79-142

SUPERIOR COURT OF CONTRA COSTA COUNTY (WELLS FARGO BANK, ET AL., REAL PARTIES IN INTEREST),

Petitioner,

VS.

SUSAN GARFINKLE, ET VIR,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION

On Petition for a Writ of Certiorari to the Supreme Court of the State of California

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In the Supreme Court of the United States

No. 79-142

SUPERIOR COURT OF CONTRA COSTA COUNTY (WELLS FARGO BANK, ET AL., REAL PARTIES IN INTEREST),

Petitioner,

VS.

SUSAN GARFINKLE, ET VIR,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION

On Petition for a Writ of Certiorari to the Supreme Court of the State of California

OPINIONS BELOW

On November 7, 1978, the Superior Court of the State of California effectively refused to enjoin a foreclosure sale of respondents' home and granted summary judgment to petitioner Wells Fargo Bank. On March 5, 1979, the California Court of Appeal ordered that the foreclosure sale be enjoined without condition and that the summary judgment be vacated. Appendix A to the Petition. On May 3, 1979, the California Supreme Court denied a hearing. Appendix B to the Petition.

None of the opinions have been or will be published, and all of them are silent as to the federal question urged in the petition for writ of certiorari.

JURISDICTION

We question whether petitioners have satisfied the jurisdictional requirements of this Court, for the reasons set forth *infra* in Section 1 of the Reasons for Denying the Writ.

QUESTIONS PRESENTED

1. Should the petition be entertained despite the failure to raise the federal question in conformance with state rules and the rules of this Court, so there is no adequate record, and the opinions below are silent as to the federal question?

2. Does the petition correctly describe the California Supreme Court's decisions?

3. Should this Court reconsider the long-standing rule, permitting states to apply judicial decisions to existing contracts, in a case where the state court merely construed a pre-existing statute and did not alter the prior law in any respect material to the case?

4. Does the United States Constitution prevent such an application where the decision supports the reasonable expectations of the contracting homeowners, while preventing the Bank from unilaterally changing its practices so as to obtain unbargained-for windfall profits?

STATEMENT OF THE CASE

For more than two decades, Wells Fargo Bank has utilized a due-on-sale clause in its real estate loan agreements. Prior to 1965, it used the clause solely to protect its security interests in the event a borrower sold the property under circumstances that impair those security interests. Even that limited use of the clause was doubtful under California statutory and case law prohibiting restraints on alienation. In 1964, the California Supreme Court held that a similar provision was permissible because it was a reasonable device to protect the lender's security interests. See Section 2, *infra*. In 1965, Wells Fargo started using the due-on-sale clause for reasons that were not related to protection of the security. In particular, the Bank began to use the clause as leverage for coercing admittedly creditworthy purchasers to pay increased interest rates and fees in order to avoid losing their homes through nonjudicial foreclosure sales.

In 1964, Michael and Gayle Lanning financed the purchase of their home through a $13,000 secured loan from Wells Fargo Bank. In 1967, the loan was revised to $19,500. The Bank did not alter the due-on clause or inform the Lannings of the 1965 change in its practice. In 1969, when the Lannings listed the property for sale, they believed and represented that the loan was assumable at its existing interest rate. Respondents agreed to purchase the property, with an assumption of the existing loan. Wells Fargo then informed re-

spondents that it would insist upon increasing the interest rate by 2¾% as consideration for waiving its purported right to foreclose. Wells Fargo has admitted that its security interests are satisfied and that its sole purpose is to use the due-on clause as leverage to obtain higher interest payments.

On January 23, 1970, respondents closed escrow while continuing to attempt to resolve the matter with the Bank. They advised the Bank that they would comply with any final judgment if the Bank desired to litigate the issue, without the need for foreclosure. They have made all monthly payments due under the note to this date. Nevertheless, on June 9, 1970, Wells Fargo initiated a nonjudicial foreclosure. They thereby forced respondents to seek injunctive relief in the federal courts, since state courts, at that time, believed that 12 U.S.C. §91 prohibited state preliminary injunctions against national banks.

While respondents were preparing a motion for an injunction, Wells Fargo agreed that it would not foreclose while the litigation was pending. In reliance thereon, respondents did not request the injunction. The district judge granted a motion to dismiss the federal action. The Ninth Circuit reversed; but it also ordered abstention, directing respondents to litigate in the state courts. *Garfinkle* v. *Wells Fargo Bank*, 483 F. 2d 1074 (9th Cir. 1973).

While the state litigation was pending, a status conference was called by United States District Judge William Orrick. As a result, counsel for all parties stipulated that Wells Fargo Bank would not attempt to foreclose "until final judgment or other final disposition of the state proceedings" and for 30 days thereafter. On May 1, 1975, the stipulation was expressly relied upon by Judge Orrick in dismissing the federal action with respondents' consent.

In 1974 and 1975, the state trial court overruled the bank's demurrers on the due-on-sale clause issue. However, it ruled against respondents as to the constitutionality of nonjudicial foreclosure. On May 16, 1978, the California Supreme Court upheld the trial court on the constitutional issue, ruling that the procedure is "private action." *Garfinkle* v. *Superior Court*, 21 Cal.3d 268 (1978). Respondents appealed to this Court. On November 6, 1978, the appeal was dismissed for "want of a substantial federal question." Mr. Justice White and Mr. Justice Marshall stated that they would note probable jurisdiction. 439 U.S. 949 (1978). See generally Grijalva, *Garfinkle* v. *Superior Court: No State Action in Nonjudicial Foreclosure*, 67 Cal.L. Rev. 684 (1979).

In the earlier decision, the California Supreme Court observed that Wells Fargo had agreed not to foreclose until the litigation was resolved, that the due-on issue was still pending, and that it also was pending in *Wellenkamp* v. *Bank of America*. *Garfinkle*, 21 Cal.3d at 273 n.3, 274 n.5. *Wellenkamp* was decided on August

25, 1978. 21 Cal.3d 943 (Appendix C to the Petition). It upheld the legal theory that respondents had urged for more than eight years. It added: "However, given the importance of the stability of real estate titles. . ., we hold that this decision shall not apply when the lender, prior to the date that this decision becomes final, has either enforced the due-on clause, resulting in sale of the subject property by foreclosure or in discharge of the acceleated debt. . . ." Appendix C at p. 17.

Despite the stipulation and federal court order, Wells Fargo prepared a "Notice of Trustee's Sale," which designated the sale date as September 22, 1978 (before *Wellenkamp* would be final), and stapled it to respondents' house. On September 14th, the trial court restrained the trustee's sale, but with the condition that if an injunction ultimately were denied, then the date of sale would be considered to be prior to *Wellenkamp's* being final. On November 7th, the trial court granted summary judgment to the Bank. It also "granted" a preliminary injunction to respondents, but only until this Court's action on the earlier case became final.

The Bank did not raise any federal question during the trial court proceedings; none of the parties made a factual record as to such issues; and the trial court did not address them.

On March 5, 1979, the California Court of Appeal granted a writ of mandate to respondents. The opinion

did not address the federal question; nor did it state the facts necessary for such a decision. Appendix A. Nevertheless, as shown in the next section, petitioner did not comply with reasonable court rules for the preservation of such issues for review by the California Supreme Court or by this Court. On May 3, 1979, the California Supreme Court denied a hearing without further comment. Appendix B.

REASONS FOR DENYING THE WRIT

I. The federal question is not properly before this Court.

Petitioner has failed to follow reasonable state procedures to secure a decision of the highest state court in which a decision could be had, within the meaning of 28 U.S.C. §1257. It also has failed to comply with Rule 23(1)(f) of this Court.

In deciding whether to grant a hearing, the California Supreme Court relies upon the statements of fact and issues set forth in the Court of Appeal decision: "On petition for hearing the Supreme Court will not examine the record for error unless the petition shows that substantial issues of law or fact were incorrectly stated or were not considered in the opinion of the Court of Appeal *and* that such issues were raised in the briefs *and* set forth in a petition for rehearing in the Court of Appeal." Cal. Rules of Ct., Rule 29 (b) (emphasis added). In this case, the Court of Appeal neither addressed the constitutional issue nor stated the facts that are relevant and necessary to resolve it.

Nevertheless, Wells Fargo did not file the required petition for rehearing; nor did its petition for hearing set forth any of the information that was required for the Supreme Court to examine the record and decide the issue.

Indeed, the record would not have been adequate for an appellate decision, since petitioner *also* had failed to raise the federal question in the trial court. As a result, the record is sparse or non-existent as to the facts that the Bank would have to establish. These include, *inter-alia*, the relevant contract date, the nature and purpose of the provision, the custom and practice, the reasonable expectations and reliance of the contracting parties, and the circumstances and effect of Wells Fargo's unilateral change in its practices regarding the provision.

Since the decisions below are silent on the federal question, the California courts are presumed to have declined to address it because of the failure to raise the question properly. *Bailey* v. *Anderson*, 326 U.S. 203, 206-207 (1945); see generally Stern & Gressman, SUPREME COURT PRACTICE at pp. 205, 214-218 (5th Ed. 1978) and authorities cited therein.

Perhaps as a result of these failures, petitioner's statement of the case also fails to comply with Rule 23(1)(f) of this Court, in that it does not specify the stage in the proceedings nor the manner in which the federal question was raised, nor the method of raising it, nor the way it was passed upon, nor such pertinent

references to the record "as will show that the federal question was timely and properly raised so as to give this court jurisdiction to review the judgment on writ of certiorari."

2. The petition misstates the holding and effect of the California Supreme Court's decisions.

Wells Fargo Bank contends that the California courts have taken away a contract right that it possessed when it entered into its contract with the Lannings. In particular, the Bank contends that *Wellenkamp* v. *Bank of America* "invalidated" the due-on-sale clause, and overruled *Coast Bank* v. *Minderhout*, 61 Cal.2d 311 (1964), which its attorney says the Bank had relied upon.

This view of the California decisions is contradicted by the language of the California Supreme Court itself:

(a) Prior to *Coast Bank*, there was considerable doubt as to whether the due-on-sale clause was enforceable for *any* purpose. See *Schneider, Debtor-Selection Provisions Found in Trust Deeds and the Extent of Their Enforceability in the Courts*, 35 S.Cal.L.Rev. 475, 476 (1962). See also cases cited in *Coast Bank*, 61 Cal. 2d at 315-316.

In *Coast Bank*, the Supreme Court declared a limited exception to the general rule prohibiting restraints: "The provision that the Enrights would not transfer the property without plaintiff's consent is a restraint on

alienation. [It] has frequently been stated that any restraint on alienation is invalid. [¶ This view] needlessly invalidates reasonable restraints designed to protect justifiable interests of the parties. [¶] . . . A restraint on alienation in an executory land contract has been upheld because of the vendor's interest in the upkeep of the property and in the character and integrity of the purchaser. In the present case it was not unreasonable for plaintiff to condition its continued extension of credit to the Enrights on their retaining their interest in the property that stood as security for the debt." *Coast Bank*, 61 Cal. 2d at 315-317 (citations omitted). See also *Wellenkamp's* description of the earlier case: "Our decision in *Coast Bank* v. *Minderhout* recognized that this rule was not absolute in its application, but farbade only *unreasonable* restraints against alienation. In determining whether a due-on clause was unreasonable in *Coast Bank*, we looked at whether the restraint was *necessary to prevent impairment to the lender's security*. We concluded that the restraint was *reasonable in that case*." *Wellenkamp*, Appendix C at p. 9 (emphasis partially added; citation omitted).

In *Coast Bank*, the lender did accelerate and foreclose upon learning of the sale. The property owner challenged the provision on its face, without regard to the purpose or circumstances of enforecement. The decision does *not* authorize a lender to use the threat of foreclosure as a means of increasing its bargained-for profits, at the borrower's expense, in a way that has

nothing to do with the justifiable interests for which the exception was created.

(b) Unlike *Coast Bank*, the issue in *Wellenkamp* was *not the facial validity* of the provision; it was the the *circumstances and procedure* under which it could be enforced: "Plaintiff contends that this clause is unenforceable absent a showing by the lender of impairment to its security; whereas defendant contends that it can automatically enforce the clause without any further showing." *Wellenkamp*, Appendix C at p. 9.

(c) As petitioner correctly states, subsequent decisions followed *Coast Bank* in upholding due-on-sale clauses, but they did so "*because such a provision is necessary to the lender's security.*" Petition at p. 5, quoting *La Sala* v. *American Sav. & Loan Assn.*, 5 Cal. 3d 864 (1971). In particular, the California Supreme Court expressly repudiated the contention that a due-on clause could be used to coerce increased profits rather than to protect security interests: "As we stated in *La Sala*, '. . . a restraint on alienation cannot be found reasonable merely because it is commercially beneficial to the restrainor.' " *Wellenkamp*, Appendix C at p. 16. Accord, *Tucker* v. *Lassen Sav. & Loan Assn.*, 12 Cal. 3d 629, 636, 640 (1974).

(d) Petitioner states that *Wellenkamp* overruled *Coast Bank*, but the overruling was expressly limited "to the extent inconsistent with this opinion." *Wellenkamp* Appendix C p. 17. The partial overruling refers to the practice of "automatic performance" of the due-

on clause, i.e., enforcing the clause, *to protect security*, without actually investigating the circumstances and being able to demonstrate that enforcement is in fact necessary. *Coast Bank* tacitly approved the practice because the lender had not demonstrated actual impairment. The change made by *Wellenkamp* is that *the lender now must undertake the burdens of investigation and proof on the security issue before enforcing the clause.*

Our case does not turn on the distinction between *Coast Bank* and *Wellenkamp*. Here, Wells Fargo did *not* automatically enforce the due-on-sale clause. It *affirmatively satisfied itself that the security was protected*, and it threatened to accelerate for *the sole purpose of coercing higher interest payments* from admittedly acceptable purchasers. For these reasons, the trial court in our case ruled that respondents had stated a cause of action long before *Wellenkamp* was decided. See Appendix A at p. 1.

(e) Similarly, the limitation on *Wellenkamp's* last paragraph, limiting its applicability where there had been completed foreclosure sales, loan payoffs or modifications was *not* a determination that Wells Fargo's conduct was legal before *Wellenkamp*. The Supreme Court simply recognized "the importance of the stability of real estate titles and the interest in preserving completed real estate financing arrangements" (Appendix C at 17) and determined that the decision would not be used to upset those events that had already been

completed before *Wellenkamp* clarified the "automatic peformance" issue. See also Hetland, *After Wellenkamp, Part Two: Retroactivity*, Calif. Real Estate 36 (Jan. 1979) (explaining the limitation and describing this very case: "Wells Fargo's astonishing performance seems more nearly a contempt than an alert reaction to a last chance to grab Garfinkle's house.")

3. This is not an appropriate case for reconsidering the decisions which hold that the states may apply judicial decisions to existing contracts.

Petitioner asks this Court to reconsider the long line of cases that held that the Federal Constitution permits retroactive application of judicial decisions, even where contracts were made on the faith of contrary case law. See, e.g., *Tidal Oil Co.* v. *Flanagan*, 263 U.S. 444, 451 & n. 1 (1924) (citing 19 such cases more than half a century ago) ; and see cases cited in the Petition at p. 9.

Respondents are prepared to defend these decisions as both necessary and proper. Indeed, a ruling that court decisions may not be applied to existing contracts would effectively immunize even the most obsolete, erroneous or short-sighted decisions and lender practices. Few homeowners will risk litigation if they cannot benefit from a successful challenge.

It is not appropriate, however, for this Court to reach the federal question, since the California Supreme Court has *not* retroactively invalidated a contract provision that had been entered into on the faith of an earlier decision. Several points illustrate this fact.

(a) Contrary to petitioner's assertion, the relevant contractual relationship was established in 1964. In 1967, the terms were merely revised, without any change in the due-on-sale clause. In 1964, petitioner had an established practice of using its due-on clauses only as a security-protection device. It changed the practice in 1965, but did not inform the Lannings of the change. In 1969, the Lannings still believed that there would not be any acceleration if they sold the property to persons who protected the Bank's security interests.

(b) As shown in Section 2, *supra*, the decision which Wells Fargo says it relied upon, *Coast Bank*, did not approve the conduct employed here. *Wellenkamp* did not change the law in any respect that is material.

(c) In all of the decisions, the California Supreme Court was interpreting a long-standing statute (Civil Code §711, as enacted in 1872 and set forth in *Wellenkamp*, Appendix C at p. 9), which had been used to prohibit the use of similar provisions prior to *Coast Bank*. See cases cited in *Coast Bank*, 61 Cal. 2d at 315-316. *Wellenkamp* simply construed the contract, as qualified by the statute, under circumstances that *Coast Bank* neither foresaw nor addressed.

4. The new rule does not impair any right in the constitutional sense.

Even if petitioner were correct in characterizing *Wellenkamp* as retroactively altering the rights that existed at the time of the contract, and even if the constitutional prohibition against legislative impairments is now to be applied to judicial decisions, the change involved here would not be unconstitutional.

This Court has repeatedly held, and recently reaffirmed, that states may enact legislation that " 'restrict a party to those gains reasonably to be expected from the contract' when it was adopted," preventing lenders from obtaining "windfall benefits" contrary to the expectations of the borrowers. *United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 31 & n. 30 (1977), and cases discussed therein. See also *id.* at 20, n. 17. That is essentially what the California Supreme Court determined would be the effect of permitting lenders to use a due-on-sale clause for the purpose of coercing an increase in the bargained-for interest rates and fees: "[It] would not further the purpose for which the due-on clause was legitimately designed, . . . [and] it would be unjust to place the burden of the lender's mistaken economic projections on property owners exercising their right to freely alienate their property. . . ." *Wellenkamp*, Appendix C at pp. 15-16.

Moreover, this Court has said that it "must decide for itself whether there was a contract, and whether the law, as enforced by the state court, impairs it." *Tidal Oil Co.* v. *Flanagan*, 263 U.S. at 453. In this case, the opinion below does not state any of the facts that will be necessary for such an assessment. The record, although incomplete as a result of the Bank's failure to raise the issue in the trial court, tends to establish that

there was no impairment of any contract. The contracting homeowners expectation, set forth in a sworn declaration, was precisely what *Wellenkamp* declared the law to be. Exhibit 12-A. Indeed, at the time of the original contract, the Bank's practice was to use the due-on-sale clause only for the protection of its security interests, which was in accordance with the homeowner's reasonable expectations and was "the purpose for which the due-on clause was legitimately designed. . . ." *Wellenkamp*, Appendix C at p. 15.

The record does not contain any competent evidence to the effect that the Bank had contrary expectations or reliance. Wells Fargo asks this Court to determine that there was an impairment of its contract rights solely on the basis of the unsworn and unsupported statement of its attorney, in the face of substantial evidence to the contrary.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Dated: November 21, 1979.

Respectfully submitted,

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Attorneys for Respondents

Supreme Court, U. S.
FILED
NOV 30 1979
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In the Supreme Court of the United States

No. 79-142

SUSAN GARFINKLE, et vir.,

Respondents,

vs.

SUPERIOR COURT OF CONTRA COSTA COUNTY
(WELLS FARGO BANK, ET AL.,
Real Parties in Interest),

Petitioners.

Petitioners' Reply to Respondents' Brief in Opposition

On Petition for Writ of Certiorari to the Supreme Court of the State of California

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In the Supreme Court of the United States

No. 79-142

SUSAN GARFINKLE, et vir.,

Respondents,

vs.

SUPERIOR COURT OF CONTRA COSTA COUNTY
(WELLS FARGO BANK, ET AL.,
Real Parties in Interest),

Petitioners.

Petitioners' Reply to Respondents' Brief in Opposition

On Petition for Writ of Certiorari to the Supreme Court of the State of California

Petitioner, Wells Fargo Bank, National Association, raised at all court levels the constitutional question it now brings before this Court.

Specifically, it was presented:

1. To the Trial Court by its Memorandum Regarding Proposed Class and Class Notice, filed February 27, 1978, by its Supplemental Points and Authorities in Support of Motion for Summary Judgment, filed September 12, 1978, by its Reply to Plaintiffs' Opposition to Motion for Summary Judgment, filed September 13, 1978;

2. To the Intermediate Appellate Court by its Response to Petition for Extraordinary Relief, filed January 5, 1979;

3. To the California Supreme Court by its Petition for Hearing, filed April 16, 1979.

Excerpts from these papers are set forth in Appendix A. Respondents' representations to the contrary are false.

DATED: November 29, 1979

Respectfully submitted,

DAVID W. LENNIHAN

BROBECK, PHLEGER & HARRISON
DAVID J. BROWN
of Counsel.

(Appendix follows)

Appendix A

FILED
Feb 27 1978
J. R. OLSSON, County Clerk
Contra Costa County
By J. PUGH, Deputy

Superior Court of the State of California
County of Contra Costa

No. 143399

SUSAN GARFINKLE, et ux.,
Plaintiffs,

vs.

WELLS FARGO BANK, et al.,
Defendants.

Memorandum Regarding Proposed
Class and Class Notice

. . . A. *Decisions changing formerly well-settled contract law are not given retroactive application to impair rights under contracts entered into when the formerly well-settled rule was applicable.*

Plaintiffs' assumption underlying this purported class action is that a result in *Wellenkamp v. Bank of America,* No. L.A. 30776, Supreme Court of the State of California favorable to the plaintiffs there, will inure to the benefit of plaintiffs here and the class described in their proposed order. That is to say, that such a result may be given retroactive application to purchasers from a grantor who was a trustor of a Wells Fargo Bank deed of trust containing a due-on-sale clause, which trust deed was executed in 1967.

This assumption is erroneous.

It ignores the rule, having constitutional origins, that the overruling of an established judicial precedent will not be given retroactive effect to impair contracts which were valid under the formerly accepted rule.

> " '[T]o permit a subsequent judicial decision in any one case on a point of law to open and annul everything that has been done before, under a different understanding of the law, would lead to the most mischievous consequences. Fortunately for the peace and happiness of mankind, no such pernicious precedent is to be found.' " *Bank of America v. Department of Mental Hygiene,* 246 Cal. App.2d 578, 586 (1966).

* * *

The principle of which we speak was applied in 1853 by the United States Supreme Court which, in *Ohio Life Insurance and Trust Co. v. Debolt,* 57 U.S. (16 How.) 415 said:

> "Indeed, the duty imposed upon this court to enforce contracts, honestly and legally made, would be vain and nugatory, if we were bound to follow *those changes in judicial decisions which the lapse of time, and the change in judicial officers, will often produce.* * * * And the sound and true rule is, that if the contract when made was valid by the law of the State, as then expounded by all the departments of its government, and administered in its courts of justice, its validity and obligation cannot be impaired by any subsequent act of the legislature of the State, or decision of its courts, altering the construction of the law."

* * *

Since neither plaintiffs nor the purported class would benefit from any change in the law, the class should not be certified, and the Court's earlier notice of decision should be vacated. . . .

FILED
Sep 12, 1978
J. R. OLSSON, County Clerk
Contra Costa County
By J. BARLETTANI, Deputy

Superior Court of the State of California
County of Contra Costa

No. 143399

SUSAN GARFINKLE, et ux.,
Plaintiffs,

v.

WELLS FARGO BANK, et al.,
Defendants.

Supplemental Points and Authorities in Support of Motion for Summary Judgment

The Supreme Court's ruling in *Wellenkamp v. Bank of America* (a copy of which is attached as Exhibit A to the initial memorandum of points and authorities) overruling the validity of due-on-sale clauses for absolute sales in certain instances cannot constitutionally be given retroactive application to notes and deed of trust contracts which were legal and binding prior to the Court's decision to change the law.

To do otherwise ignores the rule, having constitutional origins which precludes the giving of retroactive effect to a decision overruling established judicial precedent so as to impair contracts which were valid under the formerly accepted rule:

> " '[T]o permit a subsequent judicial decision in any one case on a point of law to open and annul everything that has been done before, under a different understanding of the law,

would lead to the most mischievous consequences. Fortunately for the peace and happiness of mankind, no such pernicious precedent is to be found.' " *Bank of America v. Department of Mental Hygiene,* 246 Cal. App.2d 578, 586 (1966).

The full principle is announced in *Mitchell v. National Auto. & Casualty Ins. Co.,* 38 Cal.App.3d 599, 604 (1974):

"Although it is the general rule that a decision by a court of supreme jurisdiction overruling a prior decision is retrospective [sic] in operation, there is a well-recognized exception to this rule: Where a statute has received a given construction by the court and contracts have been made or property rights acquired in accordance with the court's decision such contracts will not be invalidated nor will vested rights acquired under the decision be impaired by a change in construction adopted in a subsequent decision. In such a situation, the later decision will be given prospective and not retrospective [sic] effect."

The principle of which we speak was applied in 1853 by the United States Supreme Court which, in *Ohio Life Insurance and Trust Co. v. Debolt,* 57 U.S. (16 How.) 415 said:

"Indeed, the duty imposed upon this court to enforce contracts, honestly and legally made, would be vain and nugatory, if we were bound to follow *those changes in judicial decisions which the lapse of time, and the change in judicial officers, will often produce.* * * * And the sound and true rule is, that if the contract when made was valid by the law of the state, as then expounded by all the departments of its government, and administered in its courts of justice, its validity and obligation cannot be impaired by any subsequent act of the legislature of the State, or decision of its courts, altering the construction of the law."

Bank of America v. Burg Bros., 31 Cal.App.2d 352 (1939); *Bennett v. Superior Court,* 5 Cal.App.2d 13 (1935); *Brown v. Ferdon,* 5 Cal.2d 226 (1936); *Craemer v. Norton Realty,* 33 Cal. App.2d 340 (1939); *Drapeau v. Smith,* 34 Cal.App.2d 84 (1939); *Hales v. Snowden,* 19 Cal.App.2d 366 (1937); *Kirkpatrick v. Stelling,* 36 Cal.App.2d 658 (1940); *Shelly v. Kraemer,* 334 U.S. 1 (1947).

See also Westbrook v. Mihaly, 2 Cal.3d 765, 800 (1970) and *Forster Shipbuilding Co. v. County of Los Angeles,* 54 Cal.2d 450 (1960).

Accordingly, it is appropriate that the Order for Certification of the Class be vacated and that this action be dismissed.

Dated: September 12, 1978

Respectfully submitted,

DAVID W. LENNIHAN
GEORGE A. CUMMING, JR.
DAVID J. BROWN
BROBECK, PHLEGER & HARRISON

By DAVID W. LENNIHAN
David W. Lennihan

FILED
SEP 13 1978
J. R. OLSSON, County Clerk
CONTRA COSTA COUNTY
By Carmen, Deputy

Superior Court of the State of California
County of Contra Costa

No. 143399

SUSAN GARFINKLE, et ux.,
Plaintiffs,

v.

WELLS FARGO BANK, et al.,
Defendants.

Reply to Plaintiffs' Opposition to Motion
for Summary Judgment

. . . This Court should not deprive the defendants of rights which exist now and will lapse on September 24, 1978, according to the decision in *Wellenkamp,* which we assert is itself an unconstitutional impairment of obligations under contracts valid when made, as we more fully show in our Supplemental Memorandum in Support of Motion for Summary Judgment currently being filed.

. . .

Plaintiffs' opposition to Defendants' Motion is without merit.

DATED: September 12, 1978.

Respectfully

BROBECK, PHLEGER & HARRISON

By DAVID W. LENNIHAN
David W. Lennihan
Attorneys for Wells Fargo Bank

FILED
JAN-5 1979
Court of Appeals App. Div.
CLIFFORD C. PORTER, Clerk
By ..... Deputy

In the Court of Appeal of the State of California
First Appellate District

Division Three

Civil No. 45643

SUSAN GARFINKLE and GARY GARFINKLE,
Petitioners,

v.

SUPERIOR COURT OF THE STATE OF
CALIFORNIA, COUNTY OF CONTRA COSTA,
Respondent,

WELLS FARGO BANK AND AMERICAN
SECURITIES COMPANY,
Real Parties in Interest.

RESPONSE TO PETITION
FOR EXTRAORDINARY RELIEF

* * *

C. WELLENKAMP CANNOT BE APPLIED TO OLD TRUST DEEDS WITHOUT DEPRIVING THEIR BENEFICIARIES OF DUE PROCESS AS REQUIRED BY THE FOURTEENTH AMENDMENT TO THE FEDERAL CONSTITUTION

At the time the Deed of Trust which is the subject matter of this action was made and for a considerable time thereafter due-on-sale clauses were lawfully exercisable when the trustor sold his

property to a third person. In fact, until *Wellenkamp* the validity of due-on-sale clauses, at the outright sale of property, had been sustained by the courts over a period of many years in California. *Coast Bank v. Minderhaut,* 61 Cal.2d 311 (1964); *Cherry v. Home Savings & Loan Assn.,* 276 C.A.2d 574, 580 (1969), hearing denied. *La Sala v. American Sav. & Loan Assn.,* 5 Cal.3d 864 (1971); *Tucker v. Lassen Sav. & Loan Assn.,* 12 Cal.3d 629 (1974).[2] And elsewhere. *Stith v. Hudson City Savings Institution,* 313 N.Y.S.2d 804 (N.Y. 1970); *Malouf v. Midland Federal,* 509 P.2d 1240 (Col. 1973); *Gunther v. White,* 489 S.W.2d 529 (Tenn. 1973); *Baker v. Loves Park Sav. & Loan Assn.,* 333 N.E.2d 1 (Ill. 1975); *Mutual Fed. Sav. & Loan Assn. v. Wisconsin Wire Works,* 239 N.W.2d 20 (Wis. 1976); *First Commercial Title Inc. v. Holmes,* 550 P.2d 1271 (Nev. 1976); *Century Fed. Sav. & Loan Assn. v. Van Glahn,* 364 A.2d 558 (N.J. 1976); *Miller v. Pacific First Fed. Sav. & Loan Assn.,* 545 P.2d 546 (Wash. 1976); *Crockett v. First Fed. Sav. & Loan Assn.,* 224 S.E. 2d 580 (N.C. 1976).

The result of these decisions was an expectation in parties to trust deeds that due-on-sale clauses were validly enforceable. The right of the lender to accelerate on sale of the property was and is a property right subject to the protections of the due process clause of the Fourteenth Amendment of the United States Constitution:

---

2. This precedent as to outright sales by a trustor was not disturbed by the Supreme Court in *Tucker v. Lassen Sav. & Loan Assn.*, 12 Cal.2d 629 (1974), and *La Sala v. American Sav. & Loan,* 5 Cal.3d 864 (1971). In *La Sala* the Court held:

> "[W]e have concluded that the lender may insist upon the automatic performance of the due-on-sale clause because such a provision is necessary to the lender's security." [*La Sala* at 883.]

In *Tucker,* the Court noted that its upholding of *Coast Bank* in *La Sala* had been criticized, but the Court chose not to deal with *Coast Bank* in *Tucker.* (*Tucker* at 634-635.)

> "Contract rights are a form of property and as such may be taken for a public purpose *provided that just compensation is paid. Contributors to Pennsylvania Hospital v. Philadelphia,* 245 U.S. 20 (1917); see *El Paso v. Simmons,* 379 U.S. 497, 533-534 (1965) (Black, J., dissenting)." *United States Trust Company v. New Jersey,* 431 U.S. 1, 19 (1976). (Emphasis supplied).

Wellenkamp expressly changes the prior law and takes away the due-on-sale contract right that previously existed. This taking was without compensation and thus violates due process.

* * *

Supreme Court
FILED
APR 16 1979
G. E. BISHEL, Clerk

In the
Supreme Court of the State of California

Civil No. 45643

SUSAN GARFINKLE and GARY GARFINKLE,
Petitioners,

v.

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF CONTRA COSTA,
Respondent,

WELLS FARGO BANK and AMERICAN SECURITIES COMPANY,
Real Parties in Interest.

PETITION FOR HEARING

* * *

II. *The Constitutional Question.*

As of 1970, due-on-sale clauses had been upheld by California courts as not constituting unreasonable restraints in 1964, *Coast*

Bank v. Minderhout, 61 Cal.2d 311, 1967, *Jones v. Sacramento Sav. & Loan Assn.,* 248 Cal.App.2d 522, and 1969, *Cherry v. Home Sav. & Loan Assn.,* 276 Cal.App.2d 574, *Hellbaum v. Lytton Sav. & Loan Assn.,* 274 Cal.App.2d 456, after more than a decade of wide-spread commercial custom and practice, McDearmon Affidavit, attached as an Exhibit to Exhibit A to Response to Petition for Rehearing (Modification Only) in the Court of Appeal.

This action was not filed in the State Court *until April of 1974.*[7]

It was in 1974, after the decision in *La Sala v. American Savings and Loan Association,* 5 C.3d 864 (1971) and while *Tucker v. Lassen Savings and Loan Association,* 72 Cal.3d 629 (1974) was pending in this Court, and with specific reference to *La Sala* and *Tucker,* that the Trial Court overruled petitioner's demurrer to the due-on-sale cause of action. The Trial Court in so ruling said:

> "It is the opinion of this court that the Supreme Court of the State of California must have granted a hearing in *Tucker* in order to clarify and change this existing case law, including the dicta in *La Sala.* If the Supreme Court, in *Tucker,* should rule that due-on-sale clauses are valid under all circumstances, then defendant will have the availability of other motions to attack again the first cause of action of plaintiff's complaint."

The Trial Court at this time didn't know what the law was, and said so.

A court-made change in the substantive rules of law cannot constitutionally be made applicable to contracts made before the

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7. See footnote 1, *ante.* [1. When the Supreme Court denied the Petition for Rehearing on *Wellenkamp,* it had before it all the points raised here by Petitioners. Declaration of David W. Lennihan, attached hereto as Exhibit A.]

court-made change, to any degree greater than can legislative change of the same kind.

> " '[T]o permit a subsequent judicial decision in any one case on a point of law to open and annul everything that has been done in other cases of a like kind for years before, under a different understanding of the law, would lead to the most mischievous consequences. Fortunately for the peace and happiness of mankind, no such pernicious precedent is to be found.' " *Bank of America v. Department of Mental Hygiene,* 246 Cal.App.2d 578, 586 (1966).
>
> "Although it is the general rule that a decision by a court of supreme jurisdiction overruling a prior decision is retrospective [sic] in operation, there is a well-recognized exception to this rule: Where a statute has received a given construction by the court and contracts have been made or property rights acquired in accordance with the court's decision such contracts will not be invalidated nor will vested rights acquired under the decision be impaired by a change in construction adopted in a subsequent decision. In such a situation, the later decision will be given prospective, and not retrospective [sic], effect."

Mitchell v. National Auto. & Casualty Ins. Co., 38 Cal.App.3d 599, 604 (1974).

The principle was applied in 1853 by the United States Supreme Court which, in *Ohio Life Insurance and Trust Co. v. Debolt,* 57 U.S. (16 How.) 415 (1853) said:

> "Indeed, the duty imposed upon this court to enforce contracts honestly and legally made, would be vain and nugatory, if we were bound to follow *those changes in judicial decisions which the lapse of time, and the change in judicial officers, will often produce.* . . . And the sound and true rule is, that if the contract when made was valid by the laws of the State, as then expounded by all the departments of its government, and administered in its courts of justice, its validity and obligation cannot be impaired by any subsequent act of the legislature of the State, or decision of its courts, altering the construction of the law." 57 U.S. at 432 (emphasis added).

Bank of America v. Burg Bros., 31 Cal.App.2d 352 (1939); *Bennett v. Superior Court,* 5 Cal.App.2d 13 (1935); *Brown v. Ferdon,* 5 Cal.2d 226 (1936); *Craemer v. Norton Realty Co.,* 33 Cal.App.2d 340 (1939); *Drapeau v. Smith,* 34 Cal.App.2d 84 (1939); *Hales v. Snowden,* 19 Cal.App.2d 366 (1937); *Kirkpatrick v. Stelling,* 36 Cal.App.2d 658 (1940); *Shelly v. Kraemer,* 334 U.S. 1 (1947).

See also Westbrook v. Mihaly, 2 Cal.3d 765, 800 (1970) and *Forster Shipbuilding Co. v. County of Los Angeles,* 54 Cal.2d 450 (1960).

The Constitutional defect is not under the Contract Clause; it is under the Fourteenth Amendment's guarantee of due process.

> "Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid. *Contributors to Pennsylvania Hospital v. Philadelphia,* 245 U.S. 20 (1917); *see El Paso v. Simmons,* 379 U.S. 497, 533-534 (1965) (Black, J., dissenting)." *United States Trust Company v. New Jersey,* 431 U.S. 1, 19 n. 16 (1976) (emphasis added).

The Court should not indulge in "the fiction that the law now announced has always been the law . . ." *Chevron Oil Co. v. Huson,* 404 U.S. 97, 107 (1971) "[A] change of judicial decision after a contract has been made on the faith of an earlier one the other way is a change in the law." Holmes, J., in *Kuhn v. Fairmont Coal Co.,* 215 U.S. 349, 371 (1910).

Courts therefore apply to contracts the law as it existed when the contracts were made. *Gelpcke v. Dubuque,* 1 Wall. 175 (1863), *Green County v. Conness,* 109 U.S. 104 (1883); *Linkletter v. Walker,* 381 U.S. 618, 624, 625 (1964); *Chevron Oil*

Co. v. Huson, supra, 106, 107 (1971); *Alan v. County of Wayne,* 200 N.W. (Mich.) 628, 678 (1972).

Where a clause imposing a continuing duty, formerly found valid, is later found invalid, the clause is treated as valid up to the time when the law with respect to its validity was changed. *Bendix Corporation v. Balax, Inc.,* 471 F.2d, 149, 158 (1972).

While this Court in *Wellenkamp* does not say that due-on-sale clauses were invalid and unenforceable in 1967, the Constitution would restrain it from doing so.

* * *

CERTIFICATE OF SERVICE

DAVID W. LENNIHAN states that he is a member of the Bar of this Court; that on November 29, 1979, he deposited in the mail at San Francisco, California, four (4) sealed envelopes, with postage fully prepaid thereon, containing three (3) copies of the foregoing Petitioners' Reply to Respondents' Brief in Opposition, addressed as follows:

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San Francisco, CA 94102

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